# ROTHMANS OF PALL MALL CANADA LIMITED | ANNUAL REPORT 1966


Rothmans
THE GREATEST NAME
IN CIGARETTES
MADE IN CANADA
FAMOUS THROUGHOUT
THE WORLD
KING SIZE
20
CIGARETTES
Rothmans
KING SIZE
BY SPECIAL APPOINTMENT
FILTER TIPPED
ROTHMANS OF PALL MALL CANADA LIMITED

# ROTHMANS OF PALL MALL CANADA LIMITED

## ANNUAL REPORT 1966

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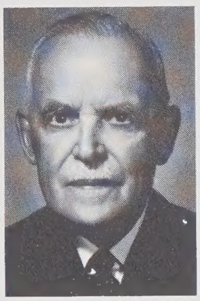
JOEL W. ALDRED


HAROLD S. FOLEY

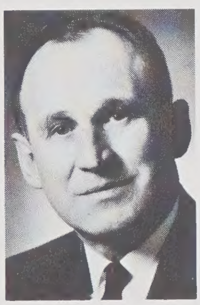

FREDERICK ANSALDO


CHARLES A. MASSEY


SIR FRANCIS DE GUINGAND


RT. HON. L. S. ST-LAURENT


JOHN H. DEVLIN


JOHN E. SHAFFNER


SHIRLEY G. DIXON


WILMAT TENNYSON

## *Directors:*

JOEL WALKDON ALDRED

FREDERICK ANSALDO

MAJOR GENERAL SIR FRANCIS DE GUINGAND, K.B.E., C.B., D.S.O.

JOHN HERBERT DEVLIN

SHIRLEY GREENSHIELDS DIXON, O.B.E., Q.C.

HAROLD SCANLON FOLEY

CHARLES ALBERT MASSEY

THE RIGHT HONOURABLE LOUIS STEPHEN ST-LAURENT, Q.C., LL.D., P.C.

JOHN ELVIN SHAFFNER

WILMAT TENNYSON

## *Officers:*

*Chairman of the Board*
THE RIGHT HONOURABLE LOUIS STEPHEN ST-LAURENT, Q.C., LL.D., P.C.

*President*
JOHN HERBERT DEVLIN

*Treasurer*
PAUL JACOBUS ERASMUS

*Secretary*
ROBERT HOWIE HAWKES

*Head Office:*
75 Dufflaw Road, Toronto 19, Ontario

*Auditors:*
PRICE WATERHOUSE & CO.

*Bank:*
BANK OF MONTREAL

*Registrar & Transfer Agent:*
THE ROYAL TRUST COMPANY

*Solicitors:*
WAHN, MAYER, SMITH, CREBER, LYONS, TORRANCE & STEVENSON

# Directors' Report

New records were again set for sales and earnings in the financial period ended June 30, 1966. Sales increased by $12,272,000 or a 9 percent gain, and net earnings increased by $708,000 or a 29 percent gain over the previous year. Earnings per share increased from $1.89 to $2.44.

As stated in the interim report for the six months ended December 31, 1965, your Company adopted the policy of relating the amount of income taxes charged against earnings to "accounting income" rather than the previous basis of "taxable income". This change is fully explained under the heading "Income Taxes" on Page 8 of the Financial section of this report. In order to provide a meaningful comparison, all relative figures in previous financial years shown in this report have been restated to reflect this change in accounting.

| FINANCIAL YEARS ENDED JUNE 30 | 1966 | 1965 | INCREASE |
|---|---|---|---|
| SALES | $147,076,000 | $134,804,000 | 9% |
| EARNINGS: | | | |
| Before Taxes | 6,590,000 | 5,297,000 | 24% |
| Net | 3,166,000 | 2,458,000 | 29% |
| Per Common Share | $2.44 | $1.89 | 29% |

If the provision for income taxes had been calculated on the taxable income basis as in the past, net earnings for the year ended June 30, 1966 would have been $3,991,000 or $3.07 per share, compared to $3,653,000 or $2.81 per share for the year ended June 30, 1965.

Other Financial highlights during the year included the final write-off of the Establishment Account and the elimination of the indebtedness involved in the purchase of Rock City Tobacco Company (1960) Limited.

It is interesting to compare the sales and earnings results five years ago (the first full financial year after the Company issued its shares on the Canadian stock exchanges) with the sales and earnings of the present financial year. These details are outlined below:

| FINANCIAL YEARS ENDED JUNE 30 | 1966 | 1962 | NET CHANGE |
|---|---|---|---|
| SALES | $147,076,000 | $92,201,000 | +$54,875,000 |
| EARNINGS: | | | |
| Before Taxes | 6,590,000 | 2,493,000 | + 9,083,000 |
| Net | 3,166,000 | 2,505,000 | + 5,671,000 |
| Per Common Share | $2.44 | $1.93 | + $4.37 |

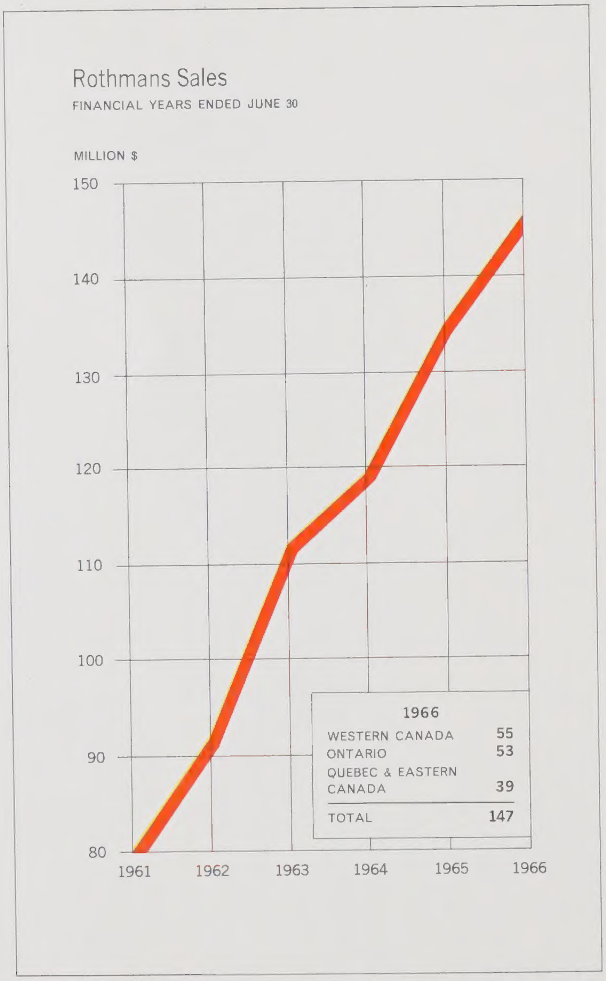
Your Company's sales continued to outpace the growth of the total industry and increased by 803,000,000 cigarettes or 9.3 percent, from 8,671 million cigarettes in 1965, to 9,474 million in the year under review.

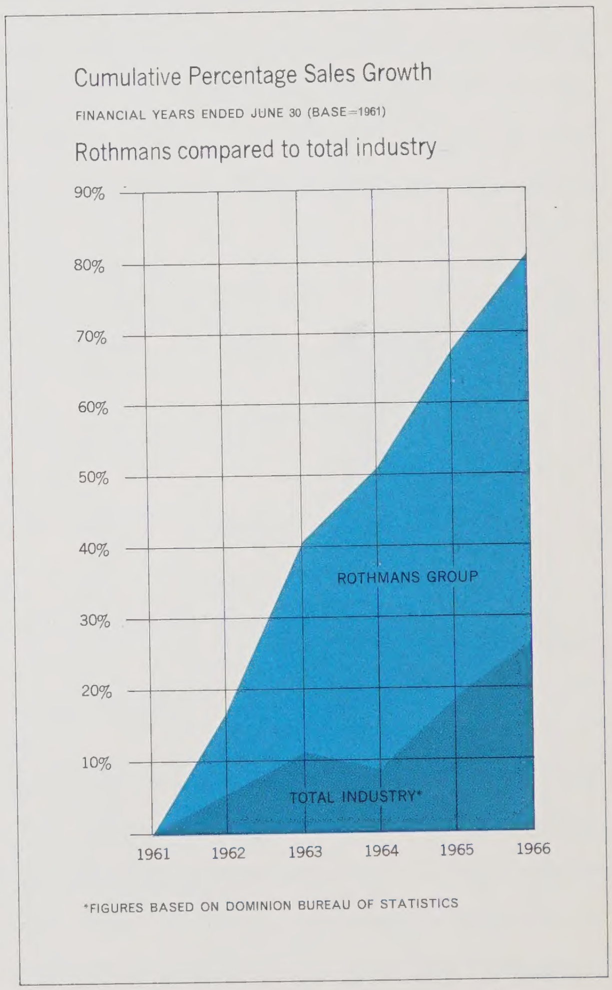
Rothmans King Size continued to be Canada's largest selling king size brand, and showed the greatest sales gain of any major brand in the cigarette industry. Number 7 and Craven Menthol showed substantial gains over the previous year. These, together with all of your Company's major brands, reached all-time record sales.

The following graph outlines the sales history of Rothmans of Pall Mall Canada Limited for the past six years. Also shown is a breakdown of sales, showing the strength by major marketing areas across the country.

Total industry cigarette production set a new record and increased by 6.2 percent to 45,085 million cigarettes, versus 42,450 million in the previous year. However, industry production figures are not an accurate gauge of over-the-counter sales. It is estimated that the sales increase for the calendar year will be approximately 4 percent, or almost comparable to the average percentage growth rate for the industry during the past ten years.

The following graph compares Rothmans sales performance with total industry over a six-year period, using 1961 as a base:



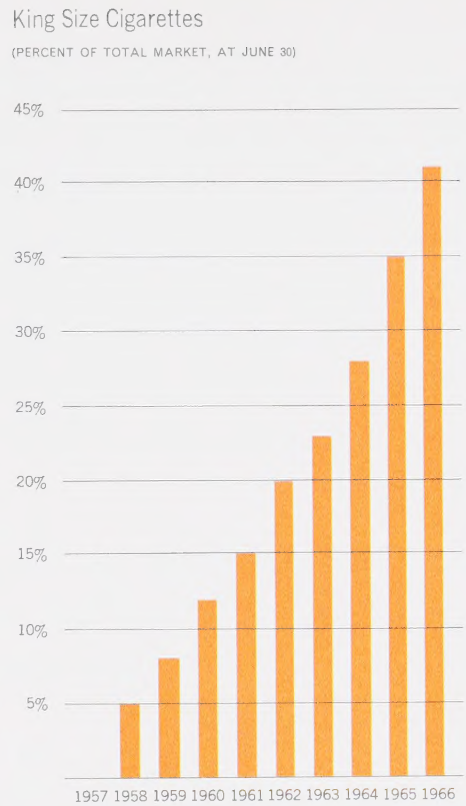



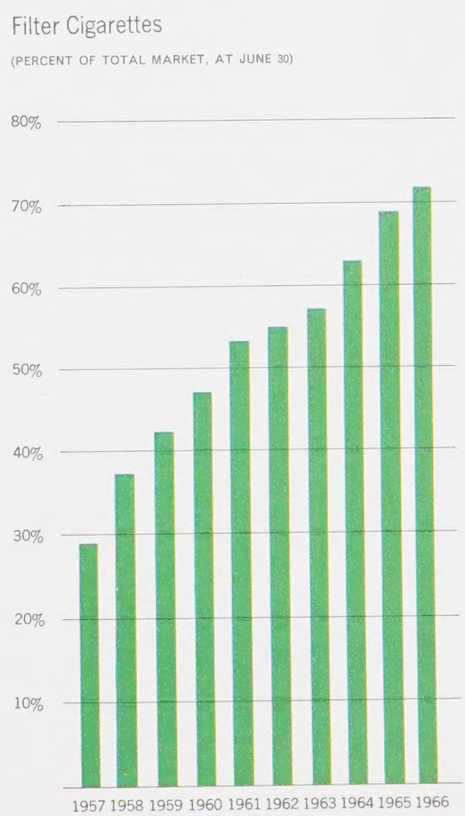
King size products continue to be the fastest-growing segment of the Canadian cigarette market, and all companies now have king size products, including king size versions of products in the market prior to Rothmans arrival in Canada. King size cigarettes now represent 41 percent of the total market, versus 35 percent in the previous year, and zero in 1957 when Rothmans introduced Canada's first king size cigarette. King size cigarettes account for 73 percent of your Company's total cigarette sales.

Filter cigarettes continue to take an increasing share of the total market, as they do throughout the world, and have now climbed to 72 percent of the total Canadian cigarette market, compared to 69 percent a year ago. Filter cigarettes account for 88 percent of your Company's total cigarette sales.

Since your Company's products are predominantly in the king size and filter fields, the two growth segments of the market, Rothmans continues to outperform the industry.

During the year, your Company concluded an agreement for the production and sale of "Dunhill" cigarettes in Canada. The product, made from a special blend of top-grade virginia tobaccos, is 95 mm., luxury length, and sells at a premium price. Dunhill cigarettes were first sold through selected retail outlets in major cities in June and consumer reaction was excellent.



Your Company also entered into an agreement with an associate company, Turmac Tobacco Company N.V. of the Netherlands, for the production and sale of "St. Moritz" cigarettes. St. Moritz is a menthol cigarette combining coolness and freshness with the finest grades of virginia tobacco. Also 95 mm. luxury length, St. Moritz sold at a premium price when it entered the market in July.

Since Canada has been traditionally a "one-price cigarette market", it will be interesting to watch the progress of these two new quality brands selling at a 5¢ premium price.

Prices paid at the latest tobacco auctions reached record highs. At 66¢ per pound, prices were 10¢ higher than for the 1964 crop, and 19¢ higher compared to the 1963 crop. In total the increase in tobacco prices since 1963 has cost the tobacco industry an additional $39 million.

Your Company paid above-average prices for tobacco to ensure continuity of the highest quality in its products.

As a result of an increase in the allotted acreage for tobacco growing by the Ontario Flue-Cured Tobacco Growers' Marketing Board, the 1966 crop is expected to yield 200 to 220 million pounds, compared to 154 million pounds in 1965. However, in spite of the larger crop, it is anticipated that average prices for this crop will remain high, since there is currently a worldwide shortage of tobacco and inventories in Canada are low.

The expansion of the Toronto factory was completed earlier this year. New warehouses in Vancouver, Calgary, Winnipeg, Montreal and Halifax are now in full operation.

During the year, the Company Pension Plans were revised and integrated with the Canada and Quebec Pension Plans. Other fringe benefits were increased at no extra cost to the employees. No major labour negotiations took place during the year, as both factories are presently operating under three-year contracts. These contracts are due for renewal in October 1967 in Toronto and March 1968 in Quebec.

The Company employs a total of approximately 1,200 employees, of which 760 are hourly paid. The annual payroll, excluding fringe benefits, is close to $7 million.

The Shareholders' Annual Meeting will take place on Tuesday, October 4, 1966. The formal notice of meeting and proxy form are sent with this report.

On behalf of the Board of Directors I wish to acknowledge the excellent co-operation and service of our many employees in Canada who served so well and loyally during the past year.

John H. Devlin

*President*

# Financial

Sales and earnings for the year under review have been dealt with in the Directors' Report. The significant improvement in earnings since 1962 is largely attributable to the continued rise in sales of the Company's products. The importance of volume in our industry is emphasized by the trend of results over the past five years.

During the financial year ended June 30, 1962, large expenditures were incurred in launching Rothmans as Canada's first international king size length cigarette, and on reversing the declining sales trend of the Rock City brands.

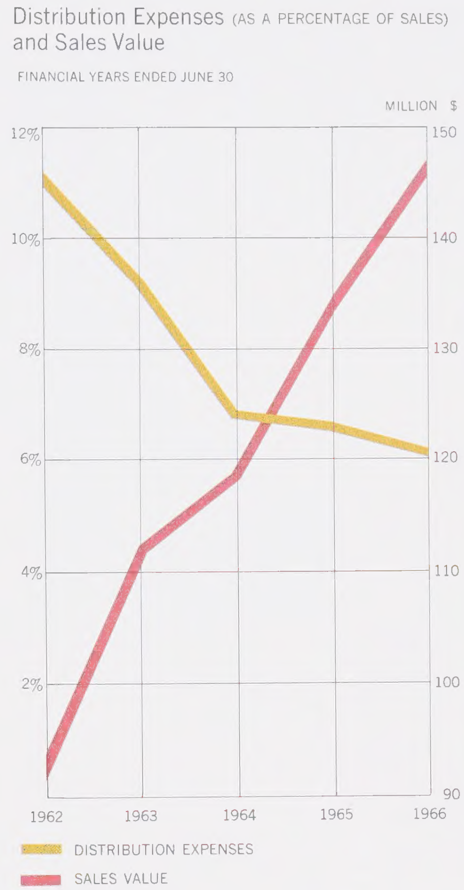
*Over the five-year period (1962 to 1966):*

—Sales have increased by 60 percent from $92,000,000 to $147,000,000.

—Profits have improved from a loss of $2,500,000 to earnings before taxes of $6,600,000.

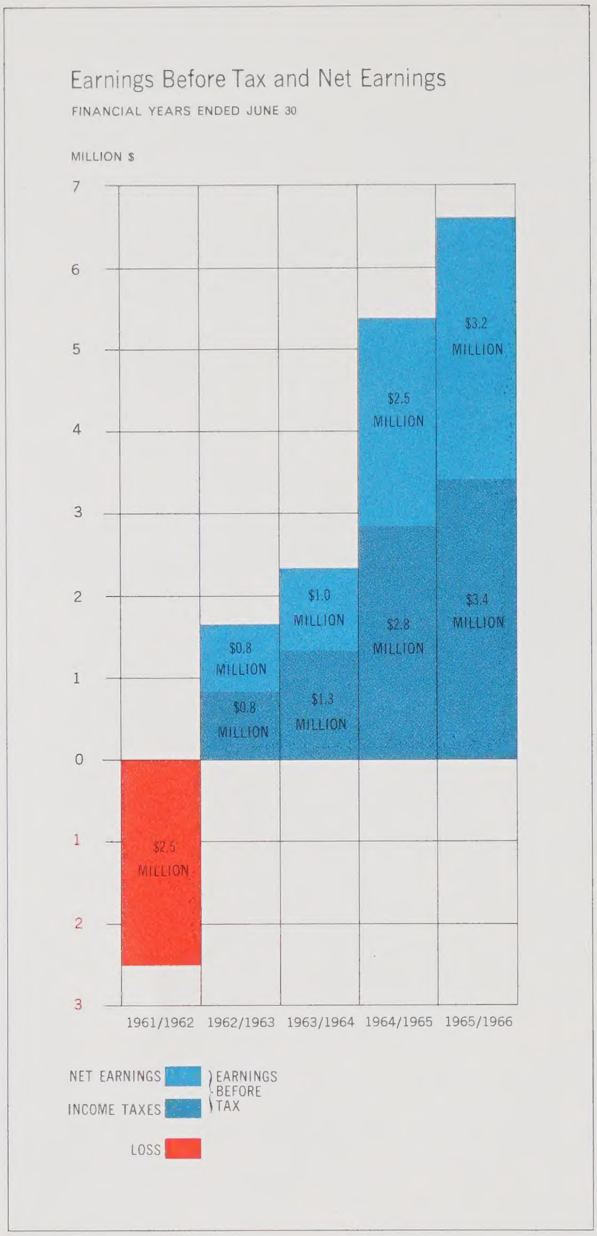
—Distribution expenses (selling, advertising and freight) in 1962 were $10,200,000 compared to $9,200,000 for the year under review. This expenditure, expressed as a percentage of sales, represents a reduction from 11 to 6 percent.

The following graph illustrates these trends:




*Note:*

*In this report, comparative figures relating to the provision for income taxes of prior years have been adjusted to give effect to the change in the basis of accounting. In addition, figures for the financial years prior to July 1, 1963, have been adjusted to give retroactive effect to the acquisition of Rock City Tobacco Company (1960) Limited.*




## Income Taxes

As stated in the Directors' Report, your Company changed its policy of accounting for income taxes during the past year. Effective with this change, the amount of income taxes charged against earnings was related to "accounting income" rather than the previous basis of "taxable income". The provision for income taxes now represents the amount of income taxes which would have been payable had there been no reductions on account of prior years' tax losses carried forward, or claims for more depreciation for tax purposes than had been charged against earnings.

Provision for income taxes charged against earnings amounted to $3,423,849 or 52 percent of earnings. The difference between income taxes charged to earnings and income taxes actually payable is outlined below:

| ($000) | 1966 | 1965 |
|---|---|---|
| Provision for Income Taxes.......... | 3,424 | 2,839 |
| Estimated Tax Reductions: | | |
| Credited to Establishment Account*.. | 825 | 1,195 |
| Credited to Deferred Income Taxes Account...................... | 529 | — |
| Total—Estimated Tax Reductions..... | 1,354 | 1,195 |
| Taxes Actually Payable.............. | 2,070 | 1,644 |

*On the Company's previous basis of accounting for income taxes, this amount would not have been included in the provision for income taxes.

The Company's reductions in income taxes have arisen from an excess of capital cost allowances claimed for tax purposes over depreciation charged to operations and, in past years, from tax losses carried forward.

In instances where there are reductions in taxes currently payable with a corresponding amount to be paid in the future, the reductions are credited to deferred income taxes. This account will be available in future years when depreciation charged in the accounts exceeds capital cost allowances available for tax purposes.

(Continued on page 16)

# *Five-Year Financial Review*

(in thousands of dollars)

| | Financial Years Ended June 30: 1966 | 1965 | 1964 | 1963 | 1962 | Change 1962 to 1966 |
|---|---|---|---|---|---|---|
| ***Sales*** | | | | | | |
| Cigarettes | $142,689 | $130,007 | $115,051 | $108,376 | $88,291 | +62% |
| Other tobacco products | 4,387 | 4,797 | 4,013 | 3,877 | 3,910 | +12% |
| Net sales | 147,076 | 134,804 | 119,064 | 112,253 | 92,201 | +60% |
| Excise duty, sales and excise taxes | 95,791 | 88,116 | 79,356 | 74,742 | 61,770 | +55% |
| Sales, excluding excise duty, sales and excise taxes | 51,285 | 46,688 | 39,708 | 37,511 | 30,431 | +69% |
| ***Earnings*** | | | | | | |
| Earnings—before income taxes | 6,590 | 5,297 | 2,308 | 1,632 | 2,493 | +9,083 |
| Income taxes | 3,424 | 2,839 | 1,302 | 821 | 12 | +3,412 |
| Net earnings | 3,166 | 2,458 | 1,006 | 811 | 2,505 | +5,671 |
| —as a percent of net sales | 2.2% | 1.8% | 0.8% | 0.7% | 2.7% | +4.9% |
| —as a percent of sales exclusive of excise duty, sales and excise taxes | 6.2% | 5.3% | 2.5% | 2.2% | 8.2% | +14.4% |
| Net earnings per common share | $2.44 | $1.89 | $0.77 | $0.62 | $1.93 | +$4.37 |
| ***Capital Expenditure—Net*** | | | | | | |
| Machinery and equipment | 1,077 | 1,716 | 1,523 | 109 | 178 | +899 |
| Other fixed assets | 1,065 | 344 | 295 | 297 | 207 | +858 |
| | 2,142 | 2,060 | 1,818 | 406 | 385 | +1,757 |
| ***Depreciation*** | 1,376 | 1,226 | 1,162 | 1,001 | 1,025 | +351 |
| ***Working Capital*** | | | | | | |
| Current assets | 43,792 | 38,431 | 32,068 | 29,945 | 26,519 | +17,273 |
| Current liabilities | 34,090 | 32,439 | 25,772 | 22,277 | 19,786 | +14,304 |
| Balance June 30th | 9,702 | 5,992 | 6,296 | 7,668 | 6,733 | +2,969 |
| Working capital ratio | 1.28 | 1.18 | 1.24 | 1.34 | 1.34 | —0.06 |
| ***Indebtedness and Interest*** | | | | | | |
| Long-term debt | 301 | 301 | 3,424 | 6,490 | 7,675 | —7,374 |
| Bank loans | 25,281 | 20,358 | 16,499 | 15,396 | 12,831 | +12,450 |
| Interest paid | 1,145 | 1,133 | 1,045 | 804 | 638 | +507 |
| ***Total Assets*** | | | | | | |
| Current assets | 43,792 | 38,431 | 32,068 | 29,945 | 26,519 | +17,273 |
| Fixed assets—net | 7,555 | 6,789 | 5,955 | 5,266 | 5,801 | +1,754 |
| Other assets | 43 | — | — | 172 | 241 | —198 |
| Intangible assets | 3,452 | 8,835 | 10,030 | 11,235 | 12,700 | —9,248 |
| Total assets | 54,842 | 54,055 | 48,053 | 46,618 | 45,261 | +9,581 |
| ***Common Shareholders' Equity*** | | | | | | |
| Common share capital issued | 13,000 | 13,000 | 13,000 | 13,000 | 13,000 | — |
| Common shareholders' tangible equity | 15,571 | 12,480 | 8,827 | 6,616 | 5,100 | +10,471 |
| Tangible equity per common share | $11.98 | $9.60 | $6.79 | $5.09 | $3.92 | +$8.06 |

# Consolidated Balance

## ASSETS

| | 1966 | 1965 |
|---|---|---|
| **Current Assets:** | | |
| *Accounts receivable—* | | |
| Trade | $ 6,484,421 | $ 5,735,219 |
| Affiliated companies | 74,518 | 5,904 |
| Other | 162,387 | 143,970 |
| | 6,721,326 | 5,885,093 |
| *Inventories, at average cost—* | | |
| Leaf tobacco | 24,675,130 | 23,151,240 |
| Manufactured stock | 10,756,482 | 7,842,719 |
| Packaging material and other | 1,415,401 | 1,434,424 |
| | 36,847,013 | 32,428,383 |
| *Prepaid expenses* | 224,148 | 117,831 |
| **Total Current Assets** | 43,792,487 | 38,431,307 |
| **Refundable Tax** | 43,422 | — |
| **Fixed Assets,** at cost (Note 1) | 16,274,302 | 14,468,549 |
| *Less*—Accumulated depreciation | 8,719,417 | 7,679,564 |
| **Total Fixed Assets** | 7,554,885 | 6,788,985 |
| **Intangible Assets:** | | |
| Establishment account (Note 2) | 8,533,320 | 8,533,320 |
| *Less*—Amortization | 8,533,320 | 3,150,000 |
| | — | 5,383,320 |
| Goodwill, at cost (Note 3) | 3,338,218 | 3,338,218 |
| Trademarks, at cost | 113,680 | 113,680 |
| **Total Intangible Assets** | 3,451,898 | 8,835,218 |
| | $54,842,692 | $54,055,510 |

APPROVED ON BEHALF OF THE BOARD:

JOHN H. DEVLIN, *Director*

JOEL W. ALDRED, *Director*

# Sheet—June 30, 1966

## LIABILITIES AND SHAREHOLDERS' EQUITY

| | 1966 | 1965 |
|---|---|---|
| **Current Liabilities:** | | |
| Bank loan (secured by inventories and accounts receivable) | $25,280,746 | $20,358,176 |
| Accounts payable and accrued liabilities | 2,024,136 | 1,625,277 |
| Income taxes | 1,062,707 | 1,562,632 |
| Excise, sales and other taxes | 5,674,685 | 5,347,002 |
| Affiliated companies— | | |
| Accounts payable | 47,924 | 16,150 |
| Note payable | — | 3,530,329 |
| **Total Current Liabilities** | 34,090,198 | 32,439,566 |
| **Deferred Income Taxes** (Note 4) | 528,640 | — |
| **Provision for Retirement Annuities** | 300,830 | 300,830 |
| **Total Liabilities** | 34,919,668 | 32,740,396 |
| **Shareholders' Equity** (Note 5): | | |
| Common stock— | | |
| Authorized— | | |
| 1,600,000 shares without nominal or par value | | |
| Issued— | | |
| 1,300,000 shares | 13,000,000 | 13,000,000 |
| Class "A" Redeemable Deferred shares— | | |
| Authorized and issued— | | |
| 180 shares of a par value of $10,000 each | 1,800,000 | 1,800,000 |
| Class "B" Convertible Deferred shares— | | |
| Authorized and issued— | | |
| 300,000 shares without nominal or par value | 3,000,000 | 3,000,000 |
| | 17,800,000 | 17,800,000 |
| Retained earnings (including $900,000 which will be designated as capital surplus on redemption of 90 Class "A" shares by December 31, 1966) | 2,123,024 | 3,515,114 |
| **Total Shareholders' Equity** | 19,923,024 | 21,315,114 |
| | $54,842,692 | $54,055,510 |

# Notes to Financial Statements

JUNE 30, 1966

**1. Fixed Assets and Depreciation:**

| | 1966 | | 1965 | |
|---|---|---|---|---|
| | Assets | Accumulated depreciation | Assets | Accumulated depreciation |
| Land | $ 208,752 | — | $ 208,752 | — |
| Buildings | 2,778,940 | 1,221,666 | 2,778,940 | 1,173,261 |
| Machinery | 11,431,303 | 6,993,729 | 10,488,731 | 6,043,290 |
| Motor vehicles | 539,530 | 265,663 | 585,827 | 298,094 |
| Leasehold improvements | 1,315,777 | 238,359 | 406,299 | 164,919 |
| | $16,274,302 | 8,719,417 | $14,468,549 | 7,679,564 |

Depreciation has been recorded using generally the diminishing balance method at the rates normally allowed for federal tax purposes. Depreciation on machinery charged to operations during the year also includes an amount of $105,000 based on the volume of production; accumulated depreciation on this basis amounts to $369,000.

Rentals payable under long-term leases approximate $356,000 annually. Of this amount $271,000 is committed for a term of not more than five years and the remainder for an average term of ten years.

Capital expenditures for the year ending June 30, 1967 are expected to aggregate $2,700,000 of which $1,530,000 has been committed.

**2. Establishment Account:**

The establishment account represented the accumulated losses of Rothmans of Pall Mall Canada Limited and two subsidiary companies from incorporation to June 30, 1959, June 30, 1961 and June 30, 1962 respectively, considered by Management as representing the cost of establishing these businesses. Since July 1, 1962, the establishment account has been amortized each year by applying reductions in income taxes arising from:

losses carried forward from prior years;

depreciation claimed for tax purposes which was charged against earnings in prior years.

In the current year this policy has been continued and all tax reductions attributable to prior years' operations have been utilized. In addition, the unamortized balance of $4,558,320 has been written off against retained earnings at June 30, 1966.

In summary, the establishment account of $8,533,320 has been amortized as follows:

| | |
|---|---|
| Reductions in income taxes—July 1, 1962 to June 30, 1965 | $3,150,000 |
| Year ended June 30, 1966 | 825,000 |
| | 3,975,000 |
| Unamortized balance written off against retained earnings at June 30, 1966 | 4,558,320 |
| | $8,533,320 |

**3. Goodwill:**

The goodwill, which arose from the acquisition of the total capital stock of Rock City Tobacco Company (1960) Limited, is represented to the extent of $3,000,000 by the entire Class "B" Convertible Deferred shares.

**4. Income Taxes:**

During the year the company changed its policy of accounting for income taxes by relating the amount of income taxes charged against earnings to "accounting income" rather than the previous basis of "taxable income". Accordingly, income taxes charged against earnings include $1,353,640 which is not currently payable. This amount arises from claiming more depreciation for tax purposes than was charged against earnings for the year.

As described in Note 2, the establishment account has been credited with $825,000 of the $1,353,640. The remaining $528,640 has been recorded in the balance sheet as "deferred income taxes" available for future years when depreciation charged in the accounts exceeds that claimed for tax purposes.

The comparative figures for the year ended June 30, 1965 have been restated to reflect the change in the policy of accounting for income taxes.

If income taxes had been provided in 1966 on the same basis as in prior years, earnings for the year would have been $3,991,230 compared to the recorded amount of $3,166,230.

**5. Class "A" and Class "B" Shares:**

The Class "A" Redeemable Deferred shares, non-dividend bearing, and non-voting (except in circumstances defined by By-Law No. 12), will be redeemable only to the extent of available funds. As more fully set out in By-Law No 12, available funds means consolidated earnings in excess of $780,000 per annum (equivalent to 6% of the company's $13,000,000 invested capital) computed on a cumulative basis commencing with the financial year ending June 30, 1966. Redemption of the shares is to be made at the rate of $10,000 per share commencing December 31, 1966 up to a maximum of 90 shares per annum. There is no time limit on the redemption of these Class "A" shares. As consolidated earnings for the year ended June 30, 1966 exceeded the requirements for available funds, 90 Class "A" Redeemable Deferred shares with a total par value of $900,000 will be redeemed by December 31, 1966.

The Class "B" Convertible Deferred shares, non-dividend bearing, and non-voting (except in circumstances defined by By-Law No. 12) will be convertible at one time, but not from time to time, upon the basis of one Class "B" share for one Common share. These shares will only be eligible for conversion to the extent of designated funds. As more fully set out in By-Law No. 12, designated funds means consolidated earnings in excess of $780,000 per annum (equivalent to 6% of the company's $13,000,000 invested capital) computed on a cumulative basis commencing with the fiscal year in which the balance of the Class "A" shares have been redeemed. When designated funds reach $3,000,000, the whole of the issue will be converted. In the event that such designated funds do not reach $3,000,000 by the end of the financial year ending June 30, 1975, shares equivalent to the amount of the designated funds at that date will be converted on the basis of one share for each $10 of designated funds, and the balance of the Class "B" shares will be surrendered to Rothmans of Pall Mall Canada Limited for cancellation. In the event that there are no such designated funds by June 30, 1975, all of the Class "B" Convertible Deferred shares will be surrendered to Rothmans of Pall Mall Canada Limited for cancellation.

**6. Excise Duty, Sales and Excise Taxes:**

Both sales and manufacturing, distribution and general expenses include excise duty, and sales and excise taxes of $96,000,000 (1965—$88,000,000).

**7. Directors' Remuneration:**

Pursuant to statutory requirements it is reported that the total remuneration paid to directors during the year ended June 30, 1966, in their capacity as directors, officers or employees, amounted to $138,000 (1965—$115,000).

ROTHMANS OF PALL MALL CANADA LIMITED
(incorporated under the Canada Corporations Act on May 8, 1956)
AND SUBSIDIARY COMPANIES

# Consolidated Statement of Earnings

FOR THE YEAR ENDED JUNE 30, 1966

| | 1966 | 1965 |
|---|---|---|
| Sales (Note 6) | $147,075,548 | $134,804,105 |
| Costs: | | |
| Manufacturing, distribution and general expenses (Notes 6 and 7) | 137,964,165 | 127,147,728 |
| Depreciation (Note 1) | 1,375,887 | 1,225,958 |
| Interest | 1,145,417 | 1,133,085 |
| | 140,485,469 | 129,506,771 |
| Earnings for the year before income taxes | 6,590,079 | 5,297,334 |
| Income taxes (Note 4) | 3,423,849 | 2,839,216 |
| Earnings for the year | $ 3,166,230 | $ 2,458,118 |

# Consolidated Statement of Retained Earnings

FOR THE YEAR ENDED JUNE 30, 1966

| | 1966 | 1965 |
|---|---|---|
| Balance at beginning of year | $ 3,515,114 | $ 1,056,996 |
| Earnings for the year | 3,166,230 | 2,458,118 |
| | 6,681,344 | 3,515,114 |
| Amortization of establishment account (Note 2) | 4,558,320 | — |
| Balance at end of year | $ 2,123,024 | $ 3,515,114 |

ROTHMANS OF PALL MALL CANADA LIMITED

(incorporated under the Canada Corporations Act on May 8, 1956)

AND SUBSIDIARY COMPANIES

# Consolidated Statement of Changes in Working Capital

FOR THE YEAR ENDED JUNE 30, 1966

| | 1966 | 1965 |
|---|---|---|
| *Working capital was increased by:* | | |
| Earnings for the year | $ 3,166,230 | $ 2,458,118 |
| Add—Expenses not involving a current outlay of funds— | | |
| Depreciation | 1,375,887 | 1,225,958 |
| Income taxes (Note 4) | 1,353,640 | 1,195,000 |
| Funds from operations | 5,895,757 | 4,879,076 |
| *Working capital was decreased by:* | | |
| Fixed asset acquisitions—net | 2,141,787 | 2,059,996 |
| Reduction in long-term portion of notes payable | — | 3,100,000 |
| Refundable tax | 43,422 | — |
| Other | — | 23,438 |
| | 2,185,209 | 5,183,434 |
| Increase (decrease) in working capital | 3,710,548 | (304,358) |
| Working capital, beginning of year | 5,991,741 | 6,296,099 |
| Working capital, end of year | $ 9,702,289 | $ 5,991,741 |
| Current assets | $43,792,487 | $38,431,307 |
| Current liabilities | 34,090,198 | 32,439,566 |
| Working capital | $ 9,702,289 | $ 5,991,741 |

## AUDITORS' REPORT

To the Shareholders of Rothmans of Pall Mall Canada Limited:

We have examined the consolidated balance sheet of Rothmans of Pall Mall Canada Limited and subsidiary companies as at June 30, 1966 and the consolidated statements of earnings, retained earnings and changes in working capital for the year ended on that date. Our examination included a general review of the accounting procedures and such tests of the accounting records and other supporting evidence as we considered necessary in the circumstances.

In our opinion the financial statements on pages 10 through 15 present fairly the financial position of the companies as at June 30, 1966, the results of their operations and the changes in working capital for the year ended on that date, in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year, after giving retroactive effect to the change, which we approve, in accounting for income taxes described in Note 4 to the financial statements.

Toronto, July 29, 1966.

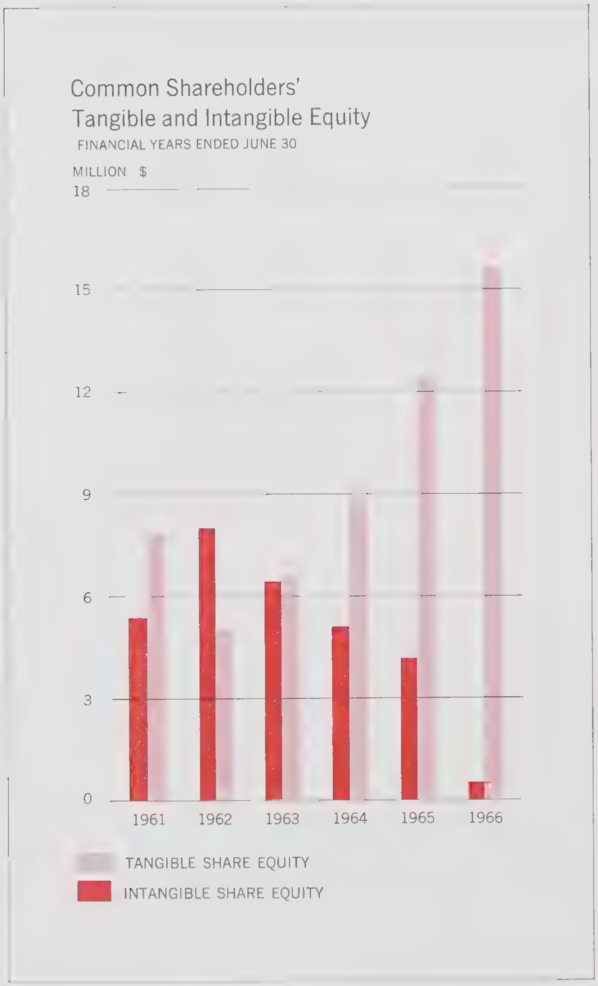
Price Waterhouse & Co., *Chartered Accountants.*

(Continued from page 8)

Where the utilization of tax reductions did not affect future taxes payable, the benefit derived was credited to the Establishment Account.

Effective May 1, 1966, a 5 percent Refundable Tax was introduced by the Federal Government. The provision for this tax amounted to $43,422 for the year under review and is refundable within a period of eighteen months following November 1, 1967.

## Shareholders' Equity




During the year under review, Common Shareholders' Equity in tangible assets increased by $3.1 million to $15.6 million, or from $9.60 to $11.98 per Common share.

Of the 180 Class "A" shares, 90 have become eligible for redemption not later than December 31, 1966, at a value of $900,000. If the present trend of earnings continues, the remaining 90 Class "A" shares will be eligible for redemption within the six months following June 30, 1967.

The earliest possible date for the conversion of the 300,000 Class "B" shares into Common shares is June 30, 1968.

The conditions for redemption and conversion of the Class "A" and Class "B" shares, respectively, are set out in Note 5 to the financial statements.

## Establishment Account

A highlight of the year was the amortization of the Establishment Account. At June 30, 1962, the total Establishment Account amounted to $8,533,000. It will be recalled that this amount represented the initial cost of establishing Rothmans of Pall Mall Canada Limited, Rock City Tobacco Company (1960) Limited and subsidiary companies.

Commencing with the year ended June 30, 1963, the Companies applied, against the Establishment Account, amounts equal to reductions of income taxes referred to in this report under the heading "Income Taxes".

In summary, the amortization of the Establishment Account was as follows:

| | |
|---|---|
| Balance June 30, 1962 | $8,533,000 |

Estimated Tax Reductions Applied
Against Establishment Account
Years Ended June 30:

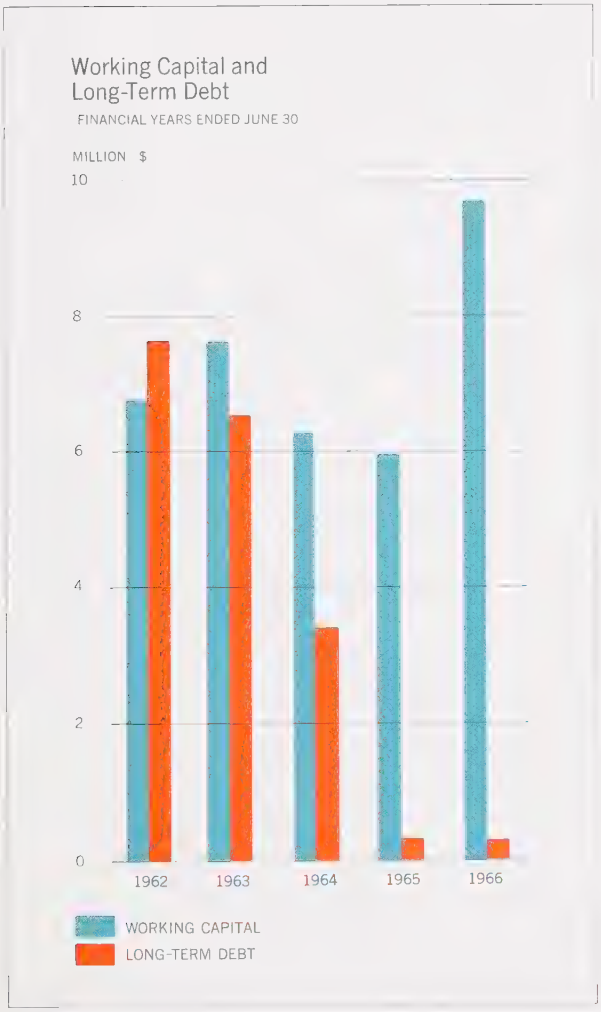
| | |
|---|---|
| 1963 | $ 740,000 |
| 1964 | 1,215,000 |
| 1965 | 1,195,000 |
| 1966 | 825,000 |
| Balance Written Off Against Retained Earnings | 4,558,000 |
| | $8,533,000 |

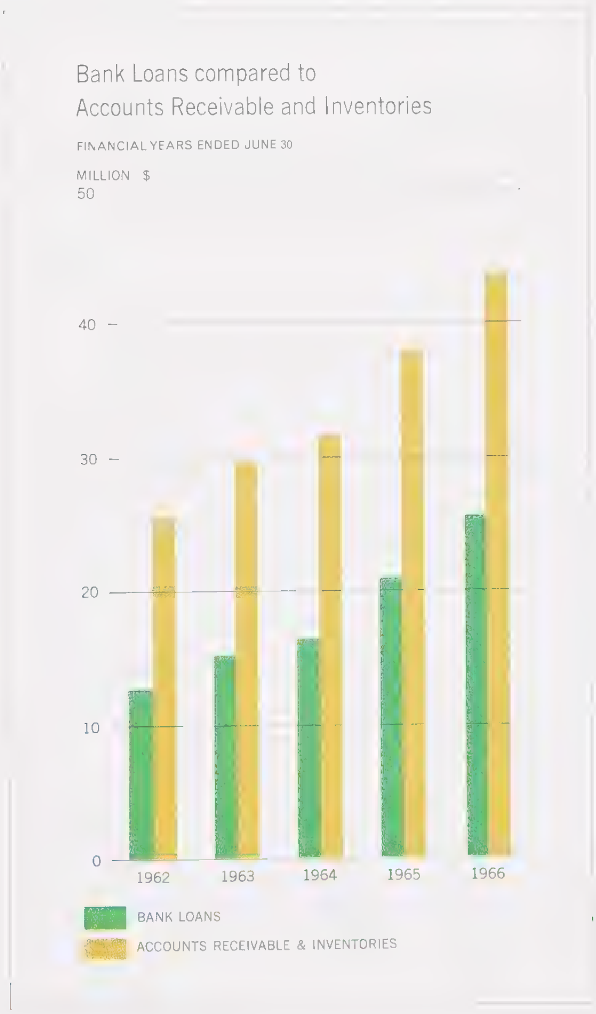
### Working Capital

Working Capital at June 30, 1966 amounted to $9,702,000 compared to $5,992,000 in 1965, an increase in working capital ratio from 1.18 to 1.28.

### Bank Loans, Notes Payable and Interest

Bank loans at June 30, 1966 were $25,281,000 compared to $20,358,000 at June 30, 1965. The increase in bank loans is attributable to higher inventories and accounts receivable necessitated by the growth in sales, and the significant increase in tobacco costs.



The following analysis outlines the changes in bank loans over the past two financial years:

| ($000) | 1966 | 1965 |
|---|---|---|
| *Bank Loans Increased by:* | | |
| Current Assets—increase | | |
| Inventories | 4,419 | 5,488 |
| Accounts Receivable & Other | 942 | 875 |
| Decrease in Working Capital | — | 304 |
| | 5,361 | 6,667 |
| *Bank Loans Reduced by:* | | |
| Other current liabilities—increase (decrease) | (3,272) | 2,808 |
| Increase in Working Capital | 3,710 | — |
| | 438 | 2,808 |
| Net Change in Bank Loans | 4,923 | 3,859 |
| *Bank Loans:* | | |
| Beginning of Year | 20,358 | 16,499 |
| End of Year | 25,281 | 20,358 |

On December 31, 1965, the final repayment of $3,100,000 was made on the Notes Payable. This debt, which was incurred at the time of acquisition of Rock City Tobacco Company (1960) Limited in 1963, originally amounted to $7,365,000. Repayments have all been financed out of earnings.

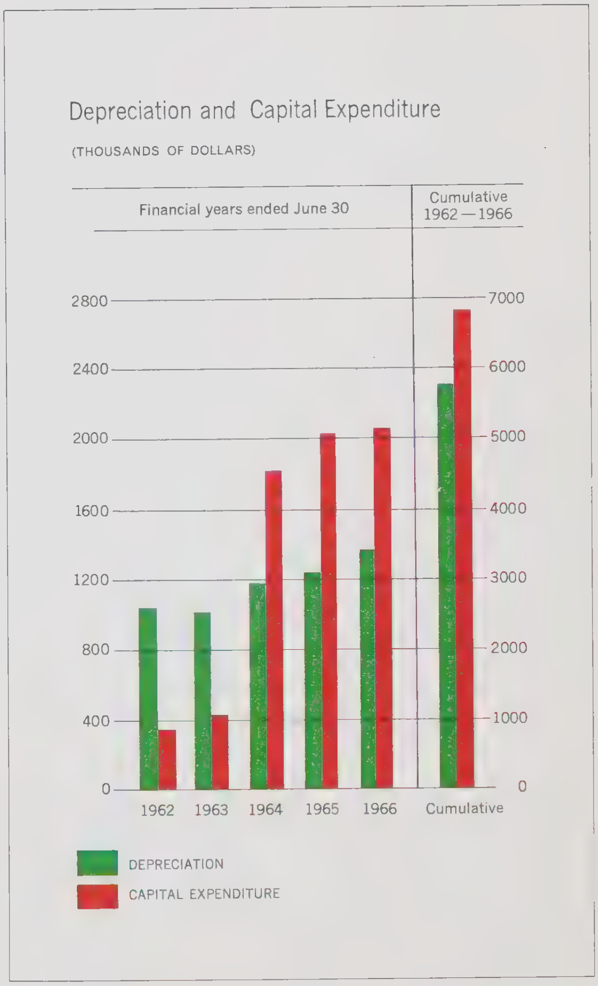
Interest paid during the year compared to the year previous was as follows:

| *Financial Years Ended June 30:* | 1966 | 1965 |
|---|---|---|
| Bank | $1,056,000 | $ 884,000 |
| Notes Payable | 77,000 | 230,000 |
| Other | 12,000 | 19,000 |
| Total Interest Paid | $1,145,000 | $1,133,000 |

Capital Expenditure and Depreciation

Net capital expenditure for the year under review amounted to $2,142,000. The major portion of this expenditure was utilized for equipment at the Toronto and Quebec factories (including equipping the Toronto plant extension).

Capital expenditure for the year ending June 30, 1967 is budgeted at $2,700,000. The greater part of this amount has been allocated for the purchase of additional production equipment.



Depreciation for the year under review amounted to $1,376,000, representing 18.2 percent of the net fixed asset value at year end (1965: $1,226,000—18.1 percent).

As in previous years, depreciation is based on normal maximum rates allowable for federal income tax purposes. The amount charged also includes an additional provision based on the volume of production, which amounted to $105,000 in 1966 compared to $97,000 in 1965.

## Tobacco

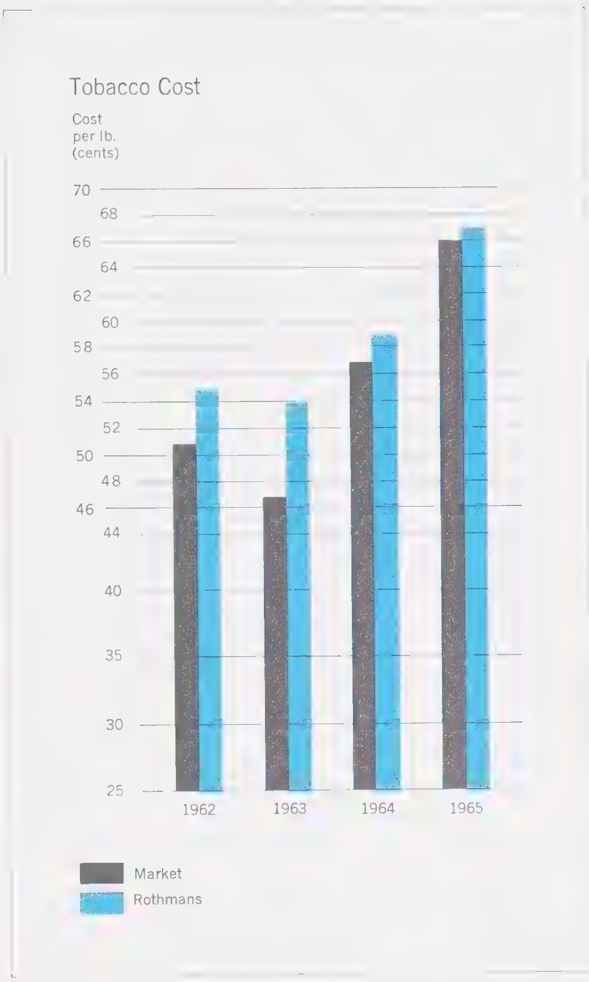
As referred to earlier in this report, there have been very significant increases in tobacco costs during this year.

| | 1965/66 | 1964/65 |
|---|---|---|
| *Flue-Cured Tobacco Crop:* | | |
| Average Price Paid by the Industry...... | 66.0¢ | 56.6¢ |
| Average Price Paid by Rothmans....... | 67.2¢ | 58.7¢ |

Since 1963, the average price paid by the industry as a whole has increased by 19¢; from 47¢ per pound to 66¢ per pound. The effect of this continued price rise since 1963 is an average annual increased cost to the tobacco industry of $19 million.

The Company's purchases of tobacco are taken to account at the close of each buying season. Inventories are valued at average cost and include the initial purchase price plus processing costs.

| *Financial Years Ended June 30:* | 1966 | 1965 |
|---|---|---|
| Value of tobacco used........ | $18,261,000 | $15,783,000 |
| Cost per pound—averaged.... | 74.4¢ | 69.9¢ |




Inventories of tobacco at June 30, 1966 amounted to $24,675,000, representing an average price of 77.7¢ per pound. In the current financial year, therefore, tobacco will be charged to operations at a significantly higher cost compared to the year under review.

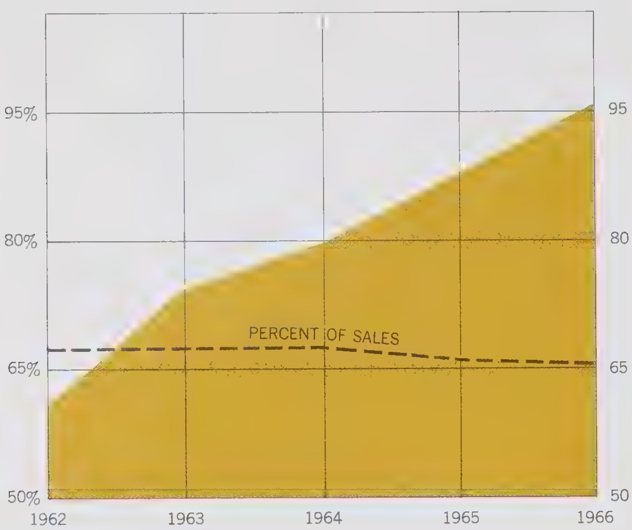
## Distribution of Sales Dollar

Charts outlining the Company's main elements of costs both in dollar value and as a percentage of sales are given on page 20 of this report.

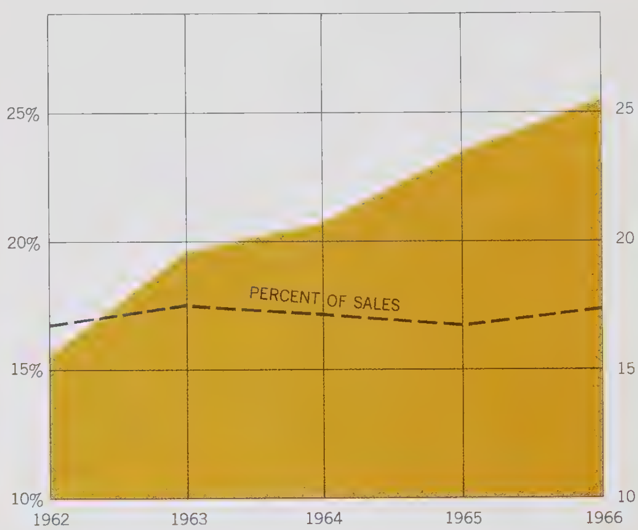
# Distribution of Sales Dollar

(FINANCIAL YEARS ENDED JUNE 30)

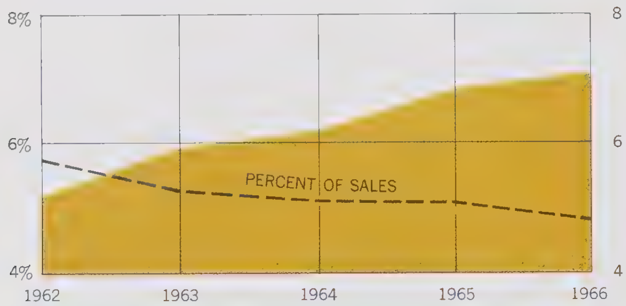
Excise Duty, Sales and Excise Taxes



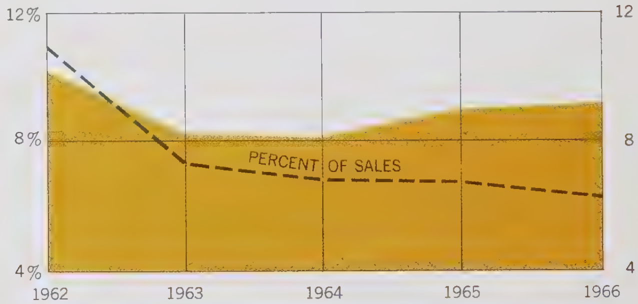

Leaf Tobacco and Packaging



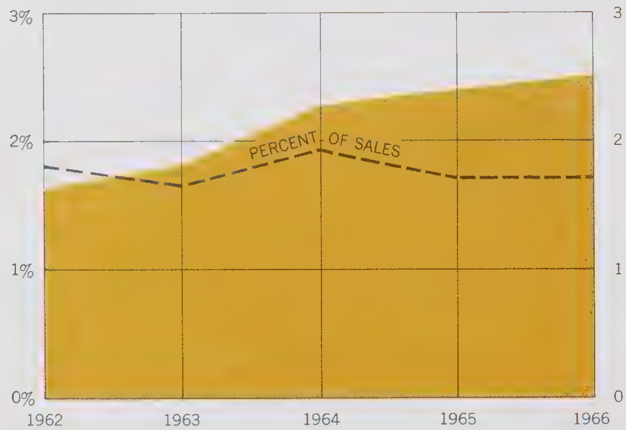

Salaries, Wages, Administration, Overheads and Other



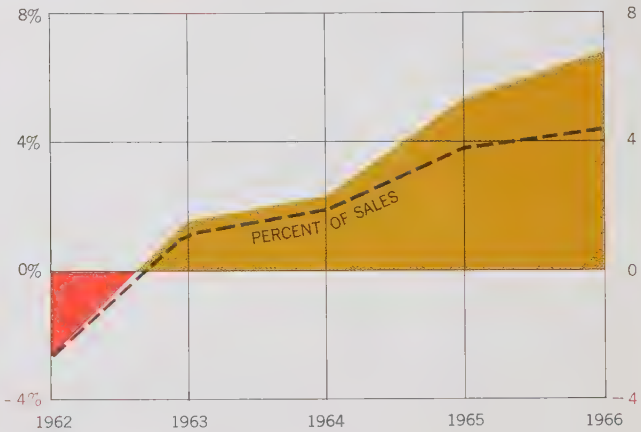

Distribution Expenses (FREIGHT, SELLING & ADVERTISING)



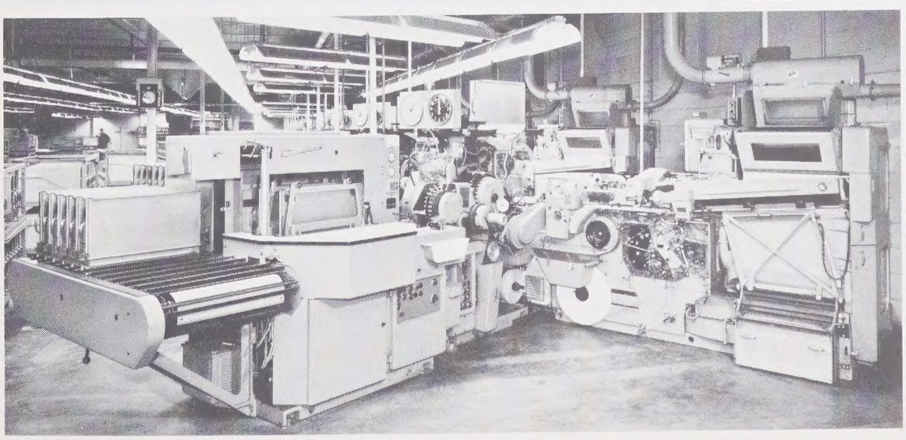

Depreciation and Interest




Earnings or Loss —Before Income Taxes

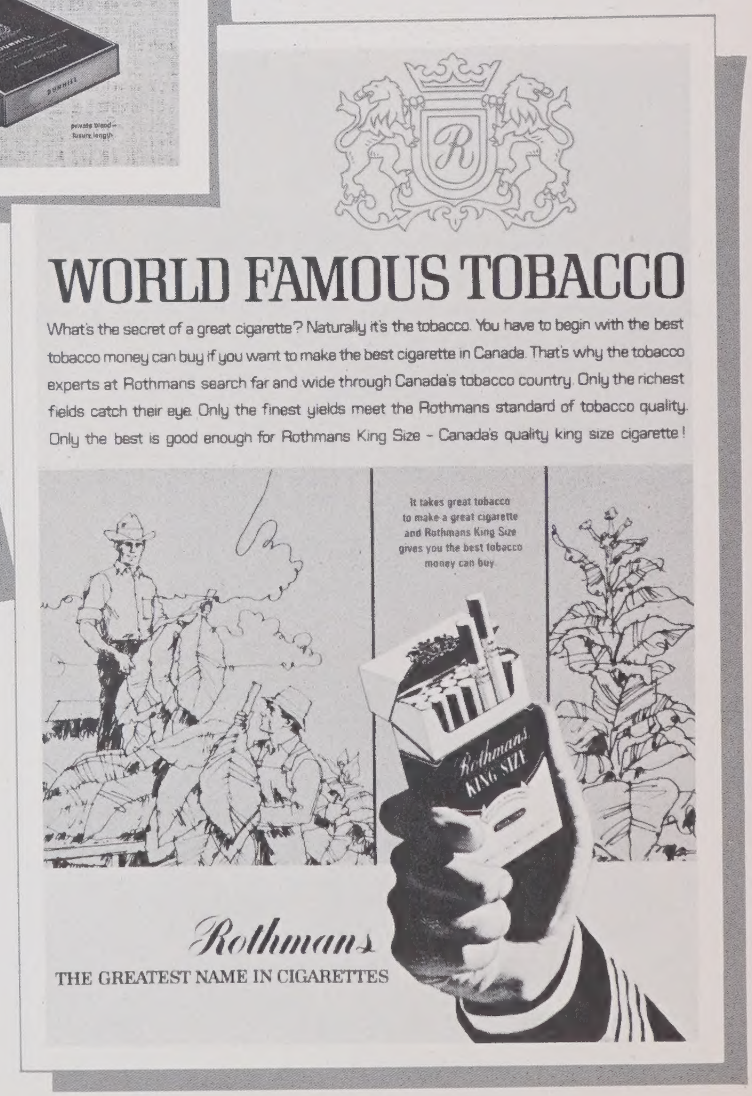


Rothmans new head office and factory building in Toronto, including interior views of the cigarette making and packing areas.








These are current newspaper and magazine advertisements for some of your Company's products, including Craven "A" King Size which will be launched in August.

NEW MEMBERS

OF OUR FAMILY

OF FINE PRODUCTS

ROTHMANS OF PALL MALL CANADA LIMITED